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No. 00-1326

In the Supreme Court of the United States

FRANKLIN P. COADY AND NONA COADY, PETITIONERS

v.

COMMISSIONER OF INTERNAL REVENUE

ON PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE NINTH CIRCUIT

BRIEF FOR THE RESPONDENT IN OPPOSITION

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QUESTION PRESENTED

Whether petitioners may exclude from their gross income the portion of the proceeds of a wrongful termination lawsuit that was retained by their attorney pursuant to a contingent fee agreement.

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OPINIONS BELOW

The opinion of the court of appeals (Pet. App. 1-12) is reported at 213 F.3d 1187. The opinion of the Tax Court (Pet. App. 23-30) is reported at 76 T.C.M. (CCH) 257.

JURISDICTION

The judgment of the court of appeals was entered on June 14, 2000. The petition for rehearing was denied on August 25, 2000. The petition for a writ of certiorari was filed on November 20, 2000. The jurisdiction of this Court is invoked under 28 U.S.C. 1254(1).

STATEMENT

1. Petitioner Nona Coady filed a lawsuit against her former employer seeking damages for a wrongful termination of her employment. Pet. App. 25. In connection with that suit, petitioner entered into a contingent fee agreement with her attorney. Under that agreement, the attorney was to be paid all costs incurred in conducting the litigation and one-third of any recovery obtained without an appeal and forty-five percent of any recovery obtained after a notice of appeal was filed. *Id.* at 24-25. In 1991, petitioner received a damages award in the total amount of $373,307. That award consisted of $89,225 for lost past earnings, $76,980 for lost future earnings, and $207,102 for lost pension and fringe benefits. Pet App. 25.

The damage award was paid to petitioner in 1994. In that same year, petitioner paid her attorney a total of $221,338, of which $124,436 represented the one-third contingent fee and $96,903 represented litigation costs. Pet. App. 25.

2. On their federal income tax return for 1994, petitioners treated all of the damages award except the portion representing lost past wages as income from self employment. Pet. App. 25. Petitioners claimed that the attorney's fees and costs that they attributed to the "self-employment" portion of their recovery ($168,217) was deductible from that specific part of their income. *Id.* at 25-26 & n.2. Petitioners also claimed a miscellaneous itemized deduction of $53,121 from their other income for the remaining legal fees and costs. *Id.* at 26.

On an audit, however, the Internal Revenue Service determined that petitioners were required to include the entire award in their gross income and that all of

the legal fees and costs (totaling $221,338) were deductible only as a miscellaneous itemized deduction. Pet. App. 26. These determinations resulted in a deficiency in tax in the amount of $49,531. *Id.* at 23.

3. Petitioners challenged the Service's determination in the Tax Court. Petitioners asserted that the portion of the award paid to their attorney under the contingent fee agreement should be excluded from their gross income and therefore not be subject to tax. The Tax Court concluded, however, that the entire amount of the award is to be included in gross income and that the attorney's fees are deductible only as miscellaneous itemized deductions. Pet. App. 26, 27-30. The court therefore upheld the Service's deficiency determination.

4. The court of appeals affirmed. Pet. App. 1-12. The court concluded that, under the applicable state attorney's fee lien statute, "an attorney obtains a lien which attaches to property belonging to the client; [the statute] does not confer any ownership interest upon attorneys or grant attorneys any right and power over the suits, judgments, or decrees of their clients." *Id.* at 9. Since the entire amount of the award was in lieu of wages and compensation, the court held that it was "clearly gross income." *Ibid.* The court concluded that the fact that a portion of the recovery was ultimately paid to the attorney under the contingent fee agreement did not mean that the recovery was not included in the gross income of the taxpayer, for in *Lucas* v. *Earl*, 281 U.S. 111, 114-115 (1930), this Court "explicitly rejected the notion that taxation can be escaped by procuring payment directly to creditors or by making anticipatory arrangements to prevent earnings from

'vesting even for a second' in the person who earned it." Pet. App. 10.[1]

ARGUMENT

The decision of the court of appeals is correct and does not conflict with any decision of this Court or any other court of appeals. Further review is therefore not warranted.

The same question presented in this case was raised, and resolved adversely to the taxpayer, in *Benci-Woodward* v. *Commissioner*, 219 F.3d 941 (9th Cir. 2000), cert. denied, 121 S. Ct. 855 (2001). This Court denied the taxpayer's petition for a writ of certiorari in the *Benci-Woodward* case on January 16, 2001.[2] For the same reasons stated in our brief in opposition to the petition for certiorari in *Benci-Woodward*, the petition for a writ of certiorari should be denied in this case.[3]

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[1] The court of appeals also rejected petitioners' argument that their arrangement with their attorney constituted a joint venture or partnership for federal tax purposes. The court concluded that petitioners had failed to preserve this issue because they did not raise it in the Tax Court. Pet. App. 11-12.

[2] One month after the petition for a writ of certiorari was denied in *Benci-Woodward*, this same issue was also decided adversely to the taxpayer in *Young* v. *Commissioner*, 2001 WL 133206 (4th Cir. Feb. 16, 2001).

[3] We are providing herewith to petitioner a copy of the government's brief in opposition to the petition in the *Benci-Woodward* case.

CONCLUSION

The petition for a writ of certiorari should be denied.

Respectfully submitted.

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